

STATE OF IOWA
DEPARTMENT OF COMMERCE
UTILITIES BOARD

IN RE: NORTHERN NATURAL GAS COMPANY AND PEOPLES NATURAL GAS COMPANY, DIVISION OF UTILICORP UNITED INC., n/k/a AQUILA, INC., d/b/a AQUILA NETWORKS	DOCKET NO. INU-02-1
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ORDER DIRECTING REFUND OF AD VALOREM TAX REFUNDS

(Issued May 10, 2002)

On March 5, 2002, the Consumer Advocate Division of the Department of Justice (Consumer Advocate) filed an application with the Utilities Board (Board) requesting that the Board commence an investigation into the retention of ad valorem tax refunds by Northern Natural Gas Company (NNG) and Peoples Natural Gas Company, Division of UtiliCorp United Inc., n/k/a Aquila, Inc., d/b/a Aquila Networks (Peoples). Consumer Advocate stated that it had information NNG received a refund of ad valorem taxes of approximately \$3.15 million from producers for the period 1983 to 1989 that it had not returned to retail customers. The Iowa portion of the ad valorem tax refund is approximately \$825,000. Consumer Advocate stated that although NNG received the refund amount from the producers, NNG refused to make refunds or pass the funds to Peoples for distribution to the retail customers.

On March 11, 2002, the Board issued an order pursuant to the provisions of Iowa Code § 476.10(2001). In the order the Board stated it was necessary to

investigate any retention of ad valorem tax refunds by NNG or Peoples. The Board cited the decision from the United States Court of Appeals for the District of Columbia Circuit that held producers must refund certain Kansas ad valorem taxes that were collected in excess of the maximum lawful prices for first sales of natural gas under Title I of the Natural Gas Policy Act for the period 1983 through 1988. Public Service Company of Colorado v. Federal Energy Regulatory Commission, 91 F.3d 1418 (D.C. Cir. 1996). The Board also cited the order of the Federal Energy Regulatory Commission (FERC) issued September 10, 1997, establishing procedures for the refunding of the ad valorem taxes by the producers to the interstate pipelines. Public Service Co., et al., 80 FERC ¶ 61,264 (1997), reh'g denied, 82 FERC ¶ 61,058. The Board requested the parties respond to certain inquiries to obtain additional information concerning the retention of the ad valorem tax refunds.

On March 29, 2002, Peoples filed its responses to the Board's questions. On April 1, 2002, NNG filed its responses. The responses from NNG indicate generally that NNG admits receiving the ad valorem tax refunds from the producers and admits that it has not returned those refunds to Iowa customers. NNG bases its retention of the refunds on the contract for sale of Peoples from NNG's former parent InterNorth, Inc. (InterNorth), to UtiliCorp United Inc., n/k/a Aquila, Inc. (UtiliCorp). NNG asserts that the refunds are for non-jurisdictional sales between NNG and Peoples when the two companies were divisions within InterNorth, and the contract controls NNG's obligation to refund the money. NNG also objected to the jurisdiction of the Board to order a refund of the ad valorem tax amounts it has retained.

Peoples responded that it has refunded all of the ad valorem tax monies that it has received and that it will refund any additional amounts it receives in compliance with the Board's direction.

A review of the corporate history provides support for the Board's jurisdiction over the sales of natural gas by Peoples to Iowa customers during all times relevant to this docket and therefore jurisdiction over any refunds associated with those sales. The corporate history shows Northern Natural Gas Company (NNG-Parent) was the name of the parent corporation of Peoples Natural Gas Company (Peoples-NNG) until March 28, 1980, when NNG-Parent became InterNorth. Peoples then became a division of InterNorth (Peoples-InterNorth). Peoples-InterNorth was a public utility providing natural gas service to Iowa customers under the Board's jurisdiction as a division of InterNorth. InterNorth was also subject to Board jurisdiction as the corporation providing the retail gas service through its division Peoples-InterNorth.

After the corporate name was changed from NNG-Parent to InterNorth, InterNorth created an operating division called Northern Natural Gas Company (NNG-InterNorth). Until the sale of Peoples on December 20, 1985, InterNorth, through its division NNG-InterNorth, purchased gas from producers and through an intra-company transfer provided the gas to another division of InterNorth, Peoples-InterNorth, which then made the retail sales to Iowa customers. FERC held that the transfers of gas from NNG-InterNorth to Peoples-InterNorth were non-jurisdictional sales, since they were not sales between two separate corporate entities but were transfers within the same corporation. FERC held that NNG-InterNorth did not need to obtain "section 7 certificates because Northern (NNG-InterNorth) and Peoples

(Peoples-InterNorth) are not separate legal corporations as defined by section 2 of the Natural Gas Act, and Peoples (Peoples-InterNorth) did not need a certificate because the local distribution of gas is exempt from FERC jurisdiction under section 1(b) of the Act." Northern Natural Gas Company, Division of InterNorth, Inc., 33 FERC 61,394 (1985).

Since the purchase of the natural gas from producers and sale to Iowa retail customers was within one corporation, InterNorth, there were no interstate sales between NNG-InterNorth and Peoples-InterNorth. The purchases from producers by InterNorth through its division NNG-InterNorth and the sales were retail sales by InterNorth to Iowa customers through its division InterNorth-Peoples were all transactions taken by the same corporate entity. Since these sales were within the jurisdiction of the Board at the time they were made, the resulting refunds for overcharges during this time period are within the Board's jurisdiction.

InterNorth subsequently changed its corporate name to Enron Corporation (Enron) and then Enron Holdings, Inc., was formed on April 11, 1990. Enron Holdings, Inc., subsequently changed its name to Northern Natural Gas Company (NNG-Enron Holdings). On December 31, 1990, the property and assets of NNG-Enron Holdings were conveyed to the wholly-owned subsidiary Northern Natural Gas Company (NNG-Enron). Since then, NNG-Enron has become a wholly-owned subsidiary of Dynegy Inc. (NNG-Dynegy).

NNG has taken the position that it made all of the refunds ordered by FERC and that FERC did not require it to make refunds associated with non-jurisdictional sales. NNG states in its response, "The refunds allocated to non-jurisdictional

customers pursuant to FERC's orders are governed by the contracts between Northern (NNG) and the customers." This position is based upon the proposition that Peoples-InterNorth was a customer of NNG-InterNorth during the relevant period. NNG asserts that the contract for sale to UtiliCorp United Inc. controls the retention or refunding of the non-jurisdictional refunds.

The Board finds that this argument is not persuasive since it ignores the corporate identity between NNG-InterNorth and Peoples-InterNorth during the relevant period and ignores the express direction of FERC concerning the ad valorem tax refunds. Since the gas transactions all took place within the corporate structure of InterNorth, they were subject to the jurisdiction of the Board and NNG as the recipient of the refunds from producers has an obligation to return to overcharges to Iowa customers.

The Board also finds that the retention of the ad valorem tax refunds is a violation of FERC orders. In the order addressing the refund procedures for ad valorem taxes, FERC addressed an issue similar to the one presented by NNG concerning the retention of refunds. FERC stated with regard to producers who wanted to have any refund amounts returned by the interstate pipelines for customers who could not be located, that the producer premise was "that, if the pipeline is unable to find a particular ultimate consumer that was overcharged, the pipeline would be able to retain that consumer's portion of the refund." In response to that premise, FERC held that "this is clearly not what is intended. The pipelines will be required to pay over all refunds they receive to their customers. As set forth in Appendix E to this order, pipelines will be required to make the refunds, to the

maximum extent possible, to their customers who were actually overcharged, generally LDC's and other large end-users." Public Service Co., et al., 80 FERC ¶ 61,264 (1997). Finally, FERC stated, "the Commission will require that pipelines flow through all refunds in one way or another, without exception." Id. NNG is an interstate pipeline subject to this FERC order.

The refund procedures adopted by FERC required the interstate pipelines to serve upon the producers a statement of refunds due with respect to the ad valorem tax overcharge for the period October 3, 1983, through June 28, 1988. The order does not differentiate between jurisdictional and non-jurisdictional refunds. The producers were then to refund in full all excess revenues to the interstate pipelines, whether the refunds related to jurisdictional or non-jurisdictional sales. FERC then states it will require the pipelines to make lump sum payments to the customers actually overcharged.

The following procedure is then described by FERC: the pipeline should (1) allocate the refunds between jurisdictional and non-jurisdictional customers; and (2) allocate the total refunds due to the jurisdictional customers who were actually overcharged and make lump sum payments to the customers. 80 FERC ¶ 61,264, at Appendix E, p. 61957.

In the "Order on Rehearing" of the October 2, 1998, letter order accepting NNG's May 18, 1998, distribution report, FERC summarizes its orders concerning ad valorem tax refunds. Northern Natural Gas Company, 85 FERC ¶ 61,429 (1998).

The summary is as follows:

The Commission held producers (first sellers) must refund to the purchaser revenues in excess of maximum lawful prices that were the result of the reimbursement of the Kansas ad valorem taxes. The Commission also required the producers to refund interest on the excess revenues. The refunds were for the period October 3, 1983 through June 28, 1988, and were to be made to the pipelines by March 9, 1998. The Commission required the pipelines to file refund reports by May 18, 1988, and annually thereafter for the next five years. The Commission further required pipelines to flow through, 'the refunds, to the maximum extent possible, to their customers who were actually overcharged.' (Cite omitted). Finally, the Commission directed the pipelines to allocate the refunds between jurisdictional and non-jurisdictional customers, and then to allocate the refunds due the jurisdictional customers based on the proportion of each jurisdictional customer's purchases during the refund period compared to the total jurisdictional sales during the refund period. Public Service Company of Colorado, 80 FERC ¶ 61,264, at p. 61,954 and Appendix E at p. 61,957 (1997).

Based upon FERC's summary, the interstate pipeline, NNG, was directed to return the overcharges for ad valorem taxes to the retail customers whether jurisdictional or non-jurisdictional. FERC then proceeds to describe the method of calculating and distributing the refunds to jurisdictional customers, leaving the method of calculation and distribution for non-jurisdictional customers to the states.

NNG admits it received the refunds from the producers and the Board finds that NNG is required to return those funds to the ultimate Iowa customer. If NNG believes that it has a contract action against UtiliCorp for reimbursement of any refunded amounts that is a matter that needs to be addressed in a court of law after the ad valorem tax overcharges are passed through to Iowa retail customers. This potential contract action that NNG claims does not affect the obligation to return the ad valorem tax refunds received from the producers to Iowa customers. The refunds

made by the producers were given to NNG as a conduit to ensure the overcharges were returned to the ultimate customer. These funds were not NNG's, nor were they Peoples' or InterNorth's. The refunds were overcharges paid by Iowa customers and must be returned to those customers.

FERC has held in cases involving jurisdictional refunds, even though contractual agreements may require one company to reimburse another once the refunds are made, the primary responsibility of the interstate pipeline is to refund the money to the retail customer. The pipeline can then sue for payment by the other company in court as part of an action on the contract. In a docket involving the question of whether a producer or its successor was liable to pay the refunds, FERC held that it was enough that the producer collected the overcharge in the first instance to require the producer to refund the ad valorem tax overcharge. Panhandle Eastern Pipe Line Company, 90 FERC ¶ 61,221 (1991).

Finally, the Board finds there is no question that NNG received the refunds from the producers pursuant to a FERC order. There is no question that the FERC order required the producers to refund excess charges for natural gas sold to retail customers, whether associated with jurisdictional or non-jurisdictional sales. There is no question the Board had jurisdiction over the original retail sales and retains jurisdiction thereby over the return of the overcharges associated with those sales.

NNG received the refunds from producers and has failed to return those funds to the ultimate Iowa customer in violation of the FERC order and the decision of the Court of Appeals of the District of Columbia. The Board will direct NNG to pass the funds to Peoples with interest and Peoples in turn must refund all amounts received

from NNG to retail customers in a manner similar to the Kansas ad valorem tax refunds previously ordered by the Board.

IT IS THEREFORE ORDERED:

1. Northern Natural Gas Company shall pay with interest to Peoples Natural Gas Company, n/k/a Aquila, Inc., d/b/a Aquila Networks, within 30 days of the date of this order, the retained portion of the Kansas ad valorem tax refunds associated with retail sales to Iowa customers received from producers for the period October 3, 1983, through December 20, 1985.

2. Peoples Natural Gas Company, Division of UtiliCorp United, Inc., n/k/a Aquila, Inc., d/b/a Aquila Networks, shall file a refund plan for the disbursement of the Kansas ad valorem tax refunds consistent with the previous refund plans for previous Kansas ad valorem tax refunds within 30 days of receipt of the refunds from Northern Natural Gas Company.

UTILITIES BOARD

/s/ Diane Munns

/s/ Mark O. Lambert

ATTEST:

/s/ Sharon Mayer
Executive Secretary, Assistant to

/s/ Elliott Smith

Dated at Des Moines, Iowa, this 10th day of May, 2002.